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No. 98-315

In The

Supreme Court of the United States

October Term, 1998

AMERICAN RE-INSURANCE COMPANY and NAC REINSURANCE CORPORATION,

Petitioners,

vs.

JOHN P. CRAWFORD, INSURANCE COMMISSIONER OF THE STATE OF OKLAHOMA, AS RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Does a state court, with exclusive jurisdiction over the liquidation of an insolvent insurance company in receivership, and with custody of receivership assets, have the authority to prohibit a federal action by reinsurers against the receiver to obtain those assets?

II. By operation of the McCarran-Ferguson Act, may state laws enacted for the purpose of regulating the business of insurance suspend federal remedies granted by conflicting federal statutes?

III. Does the McCarran-Ferguson Act empower a state court with jurisdiction over the liquidation of an insolvent insurance company to enjoin prosecution of a *quasi in rem* federal court action?

LIST OF PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES OF RESPONDENT

1. Parent company of Employers National Insurance Corporation in receivership: Employers Casualty Company, a Texas insurance company in receivership, Jack M. Webb, Special Deputy Receiver.

2. There are no nonwholly owned subsidiaries of Employers National Insurance Corporation.

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Respondent respectfully requests that the Court deny the petition for writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

In addition to those listed by Petitioners, the following statutes are involved in this case: Okla. Stat. tit. 36, §§ 1918, 1927.1(A), 1927.1(B)(1), (B)(3) and (B)(6) (1991 and 1997 Supp.) These statutes are set forth in full in Respondent's Appendix, attached hereto. Further, the following statute was not set forth in full in Petitioners' Appendix, and is therefore set forth in full in Respondent's Appendix: 9 U.S.C § 4. References to Respondent's Appendix shall be in the form, "Resp. App. __a."

STATEMENT OF THE CASE

A. Proceedings In The District Court

Petitioners allege that they entered into reinsurance agreements with Employers National Insurance Corporation ("ENIC"). Respondent has, since the inception of this case, denied that it was a party to an agreement with Petitioners. Petitioners entered into reinsurance agreements only with ENIC's parent company, Employers Casualty Company ("ECC"). Respondent has always contended that its only reinsurance agreement was with its parent, ECC, a Texas insurer.

Before it was placed in receivership, ENIC paid $2,065,000, as a secondary insurer on an accident involving wrongful death claims. However, ECC, not ENIC, made claims for reinsurance against the Petitioners. Petitioners paid ECC under their reinsurance agreements. ENIC never received any reinsurance payment on the wrongful death claims, either from Petitioners or ECC. ECC has been placed in receivership in Texas.

After ENIC was placed in receivership in Oklahoma, ENIC filed a suit against the primary insurer, seeking damages for its improper handling of the claim, and recovered $1,500,000. The fund recovered is the asset of ENIC's estate. By law, the Respondent, as receiver of ENIC, is vested with title to all property of ENIC. Petitioners claimed ownership of the fund as "salvage," alleging that ENIC was a trustee for their benefit.

When Respondent declined Petitioners' claim for possession of the fund in question and refused Petitioners' written demand to submit the dispute to arbitration, Petitioners filed their Petition to Compel Arbitration under the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, in the United States District Court for the Northern District of Texas. Pertinent excerpts of the Petition are included in Appendix C. Petitioners also requested a temporary restraining order and preliminary injunction, urging that Petitioners "have advised [Respondent] that these settlement funds are not part of the ENIC insolvency estate, but as a matter of law are deemed to be held in trust by the [Respondent] for [Petitioners] as subrogees." (Resp. App. 14a.) Because Respondent refused to relinquish control of the funds to them, Petitioners urged that an injunction was necessary to preserve the status quo. (Resp. App. 14a.) *Id.*

Respondent filed a Motion to Dismiss, contending that ENIC never entered into reinsurance agreements with Petitioners and that ENIC's only reinsurer was its parent. Respondent requested a hearing in accordance with 9 U.S.C. § 4. Immediately after Petitioners filed a reply, the district court denied the motion to dismiss, failed to set a hearing, and ordered the parties to arbitrate.

Respondent filed a Motion for New Trial, Rehearing, or to Alter or Amend Judgment, still denying that ENIC was a party to the reinsurance agreement. In addition, Respondent advised the district court that the state receivership court had enjoined any actions against the Respondent. The district court denied the motion

for new trial, but noted that "the state court is the court that should interpret and enforce its injunction." (Petitioners' Appendix 42a.)[1]

Based on this order, Respondent filed in the state receivership court a Motion for Temporary Restraining Order and Preliminary and Permanent Injunction and Citation for Contempt of Court. The court denied the request for a temporary restraining order, leaving the request for a permanent injunction and citation for contempt of court for another day.

Petitioners thereafter filed in the federal district court a Motion for Temporary Restraining Order and for a Preliminary and Permanent Injunction seeking to enforce the order compelling arbitration. The court denied Petitioners' motion and clarified its previous order. The court held that "[i]f the state court determines that the filing of this action violated its injunction, this Court will respect that decision by vacating the arbitration order and dismissing this case." Respondent was "directed to file a motion to dismiss with this Court" if the state court found that Petitioners violated the injunction. (Pet. App. 34a.)

The state court determined that the filing of the Petition to Compel Arbitration violated the injunction. In accordance with the federal court's directive, Respondent moved to dismiss the federal action. The federal district court, relying upon the full faith and credit clause and the *Burford* [2] abstention doctrine, vacated its order compelling arbitration and dismissed the case. (Pet. App. 29a-31a.)

B. The Fifth Circuit's Decision On Appeal

The court of appeals upheld the federal district court's dismissal of Petitioners' Petition to Compel Arbitration, but on

1. References to "Pet. App. __a" are to the Appendix attached to the Petition for Writ of Certiorari.

2. *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

different grounds than that used by the federal district court. The court found that dismissal was not justified under *Burford*. Instead, it found that pursuant to the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015, provisions of the Oklahoma Uniform Insurers Liquidation Act ("OUILA"), Okla. Stat. tit. 36, §§ 1901-1938 (1991 and 1997 Supp.), reverse preempted the FAA. Because the provisions of OUILA preempted the FAA, the district court had no power to compel arbitration, and Respondents' Motion to Dismiss was properly granted.

In rendering its decision, the court of appeals faithfully followed this Court's decision in *United States Dep't of Treasury v. Fabe*, 508 U.S. 491 (1993), with regard to what constitutes a law "enacted . . . for the purpose of regulating the business of insurance" under the McCarran-Ferguson Act. The court found two pertinent provisions of OUILA that were clearly enacted "for the purpose of regulating the business of insurance." (Pet. App. 17a-18a.)

First, Okla. Stat. tit. 36, § 1902(A) (1991) vests the Oklahoma County District Court with exclusive original jurisdiction over all delinquency proceedings. (Pet. App. 13a.) Second, Section 1904(B) of OUILA allows the state court to issue injunctions to enforce its exclusive jurisdiction by preventing interference with the receiver and prohibiting "the commencement or prosecution of any actions." (Pet. App. 14a.) These two provisions, the court of appeals held, were aimed at aiding policyholders. (Pet. App. 20a-21a.) Further, just as this Court did in *Fabe*, the court of appeals found that these provisions did not solely provide a benefit to all creditors, but were "reasonably necessary" to further the goal of protecting policyholders. (Pet. App. 20a.) The court reasoned that these statutes, by consolidating all claims against the insolvent insurer in one court, prevented the waste of funds that would occur if the receiver were forced to "defend unconnected suits in different forums across the country," eliminated "the risk of conflicting rulings, piecemeal litigation of claims, and unequal treatment of

claimants," and conserved assets for ultimate payment to policyholders. Therefore, they were enacted for the purpose of regulating the business of insurance.

The court of appeals also found that the FAA would "invalidate, impair, or supersede" the relevant OUILA provisions. Ordering Petitioners' claims resolved in another forum directly conflicted with the exclusive forum provided by OUILA and with the power to enjoin any action interfering with the delinquency proceedings. (Pet. App. 25a.) An order compelling arbitration, the court held, would give the Petitioners exactly what OUILA and the state court injunction prohibited — an action heard outside the forum authorized by Oklahoma insurance statutes.[3] This impaired the statute under the McCarran-Ferguson Act. (Pet. App. 23a-24a.)

The Fifth Circuit noted that *Bennett v. Liberty National Fire Insurance Co.*, 968 F.2d 969 (9th Cir. 1992), is a case "similar to the instant case." The court declined to follow *Bennett*'s reasoning that "[o]nly if a court or arbitrator determines that the funds belong to [the insolvent company] does that money become part of the estate that the liquidator will distribute" and only then does the receiver's authority vest. *Citing Bennett,* 968 F.2d at 972. This analysis contravened the law long ago established by this Court that if two *in rem* or *quasi in rem* proceedings exist, the court that first assumes jurisdiction over the property exercises its jurisdiction to the exclusion of the other. *Citing Penn. Gen. Cas. Company v. Commonwealth of Pennsylvania ex rel. Schnader*, 294 U.S. 189, 195 (1935). Petitioners here claim a vested property interest in specific proceeds held by the Respondent and ultimately seek a ruling as to ownership of the fund, making their action *in rem* or

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3. Petitioners assert that neither the statutes nor the injunction "expressly" bar arbitration. However, by barring "any action," both most certainly bar the filing of a petition to compel arbitration, and should be deemed to bar any action maintained outside of a court of law, such as arbitration.

quasi in rem. Further, the state court delinquency proceedings are *in rem* or *quasi in rem*. Consequently, the Oklahoma County District Court, as the court that first assumed jurisdiction over the fund, had sole power to determine ownership. *Citing United States v. Bank of New York & Trust Co.*, 296 U.S. 463, 477-79 (1936) (federal court has no jurisdiction to decide ownership of property involved in state court insurance company liquidation proceedings). (Pet. App. 22a-23a, n. 6.)

The court's opinion also addressed the question of whether a state court can enjoin a federal court proceeding. The Fifth Circuit held that although the law is well settled that state courts cannot generally enjoin *in personam* federal actions, no decision of this Court has yet construed the effect of the McCarran-Ferguson Act on that rule of law. Congress has the power to relax the prohibition against state court injunctions of federal actions. The court found that federal policy as set forth by Congress defers to state regulation of insolvent insurance companies. The court noted that this strong federal policy is reflected in the McCarran-Ferguson Act and the statutory exclusion of insurance companies from federal bankruptcy protection. These federal laws express the public interest in having the states and state courts as the "preeminent regulators of insurance." (Pet. App. 25a.)

Accordingly, the court held that "state laws regulating the business of insurance may suspend federal remedies based on conflicting federal statutes." In other words, because the FAA was reverse preempted by the McCarran-Ferguson Act, the federal district court was left without the power to compel arbitration. (Pet. App. 25a-26a.) Therefore, dismissal of the Petition to Compel Arbitration was proper.

REASONS FOR DENYING THE WRIT

I.

THE FIFTH CIRCUIT'S DECISION CAN BE RECONCILED WITH DECISIONS IN OTHER CIRCUITS

Petitioners argue that the holding in *Bennett v. Liberty National Fire Insurance Co.*, 968 F.2d 969 (9th Cir. 1992), creates a conflict between the Ninth and Fifth Circuits. However, the Ninth Circuit dissolved any conflict that may have existed when it decided *Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372 (9th Cir. 1997) ("*Quackenbush II*").

The posture of *Bennett* differs substantially from the posture of this case and, as the Ninth Circuit noted in *Quackenbush II*, that difference is key. In *Bennett*, the liquidator filed the lawsuit under consideration in order to collect contractually owed payments. Here, by contrast, the Petitioners sued the receiver, asserting a claim against the assets held by the receiver.

When *Bennett* is read with the subsequent decision of the Ninth Circuit in *Quackenbush II*, it is clear there is no conflict between the Fifth and Ninth Circuits. In considering the effect of the McCarran-Ferguson Act on the California claims procedure, the Ninth Circuit court said:

> Under *Fabe*, there is no question that California's insurer-insolvency provisions regulate the "business of insurance" and are saved from preemption by the McCarran-Ferguson Act. Thus, Allstate [a creditor] could not invoke the FAA to compel arbitration of its claims *against* [the insolvent] Mission, which must be pursued through California's statutory insolvency scheme.

Quackenbush II, 121 F.3d at 1381 (emphasis added). Based on this language, it is clear that if the Ninth Circuit were considering the instant case today, its decision would be in accord with the Fifth Circuit's decision.

For the same reasons, the Third Circuit's decision in *Grode v. Mutual Fire, Marine & Inland Insurance Co.*, 8 F.3d 953 (3d Cir. 1993), does not present a conflict either. There, the posture of the case was the same as in *Bennett* and in *Quackenbush II*: the receiver was the plaintiff, seeking to recover a money judgment under a contract. The Third Circuit noted that "courts abstain in suits *against* insolvent companies . . . [because] a single forum [is] necessary to dispose equitably of the company's limited assets so as to avoid a race to the courthouse." *Grode*, 8 F.3d at 960. Because the suit in *Grode* was not one *against* the receiver, but one *by* the receiver, abstention was not appropriate. Thus, there is not a conflict between two circuits. Instead, there are two decisions that differ because they involve different facts.

The Fifth Circuit's decision is not in conflict with the Eighth Circuit's decision in *Murff v. Professional Medical Ins. Co.*, 97 F.3d 289, 292 (8th Cir. 1996). In Murff, an employee of an insurer was demoted, then terminated. Thereafter, the insurer was placed in rehabilitation. Murff filed an action in federal court under the Age Discrimination in Employment Act ("ADEA"), 29 U.S.C. §§ 621 *et seq*. The insurer's rehabilitation was later converted to a liquidation and an injunction issued preventing anyone from obtaining a judgment against the insurer. On motion, the federal district court dismissed Murff's case, citing the McCarran-Ferguson Act.

On appeal, the Eighth Circuit examined the McCarran-Ferguson Act and found two of the Act's three-part test satisfied: the ADEA did not specifically relate to the business of insurance and the Missouri insolvency statutes were enacted for the purpose of regulating the business of insurance. *Murff*, 97 F.3d at 291. In

these two respects, the Eighth Circuit's opinion agrees with the Fifth Circuit's decision below.

In considering the last prong of the statutory test, whether the federal statute would "invalidate, impair, or supercede" the state insolvency statutes, the Eighth Circuit found that there was

> no inherent conflict between the ADEA and the [Missouri Insolvency Act]. The ADEA does not prohibit something that the Insolvency Act commands, nor does it command something that the Insolvency Act prohibits.

Allowing the ADEA claim to proceed in federal court, it ruled, would not impair the comprehensive liquidation scheme because the ADEA claimant *would still have only a low priority claim in the receivership court* after obtaining his judgment.

Although the Fifth Circuit found that the FAA was reverse preempted by the OUILA, its decision does not conflict with *Murff*. First, the Eighth Circuit in *Murff* did not address the question of whether the FAA was preempted by the Missouri Insolvency Act. The federal statute at issue there was the ADEA. As a result, even if a conflict existed, it is, at best, an indirect conflict.

Further, the FAA does indeed impair the Oklahoma insolvency statutes. In addition to providing for exclusive jurisdiction and injunction against other actions, OUILA provides in Section 1918 for a specific claims procedure for determining the validity of claims against the insolvent estate. The statute requires the Oklahoma County District Court to conduct the hearing regarding such claims. Arbitration is not an option. Thus, the FAA and the claims procedure of the Oklahoma insolvency act are completely at odds.

Morever, the plaintiff in *Murff* sought only a money judgment. As the Eighth Circuit noted, any judgment obtained gave the

plaintiff only a low priority claim that plaintiff would still be required to pursue in the liquidation proceedings. In the instant case, on the other hand, Petitioners seek recovery of specific proceeds held by the Receiver. This factual difference in the two cases also averts a conflict between the two decisions.

Last, even though the Eighth Circuit held that the federal district court should not have dismissed the ADEA lawsuit, it did not rule that the ADEA claimant could continue his case in the federal court. Instead, the court concluded that the lower court "should not have dismissed the action but should instead have considered whether the action should be stayed." *Murff*, 97 F.3d at 293. Here, the Fifth Circuit affirmed a dismissal. However, the Eighth Circuit's suggested stay of proceedings ends with the same result: the claimant must return to the receivership court.

Petitioners also urge that the Fifth Circuit's holding here is in conflict with the First Circuit's decisions in *Fragoso v. Lopez*, 991 F.2d 878 (1st Cir. 1993) and *Garcia v. Island Program Designer, Inc.*, 4 F.3d 57 (1st Cir. 1993). There is no conflict between these decisions and the decision on appeal here.

Fragoso was a medical malpractice case in which the insurance company was sued pursuant to Puerto Rico's direct action statute. The lower court granted summary judgment, holding the case was barred by the statute of limitations. After an appeal was lodged, the insurance company was placed in delinquency proceedings. The insurance commissioner moved to consolidate the case with the delinquency proceedings or to stay it in accordance with the insurance liquidation statutes. The court denied the commissioner's request, finding that it was not warranted either under the *Erie* doctrine[4] or under *Burford* abstention principles.

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4. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

Petitioners rely on semantics to show the alleged conflict between *Fragoso* and the Fifth Circuit's decision. Parroting part of the McCarran-Ferguson Act (allowing preemption of a federal law that would "invalidate, *impair*, or supercede" the state law at issue), Petitioners assert that the First Circuit's holding that "allowing an action against an insolvent insurance company to proceed in federal court would not *impair* Puerto Rico's version of UILA," disagrees with the Fifth Circuit's decision here. (Petition for Writ of Certiorari, pp. 15-16.) However, the First Circuit was not referring to the impairment required by the McCarran-Ferguson Act. In fact, Petitioner's reliance on this case is inexplicable, because the case involved neither the McCarran-Ferguson Act nor the FAA.

The First Circuit did, however, address the application of the McCarran-Ferguson Act in connection with insurer insolvency statutes in *Garcia v. Island Program Designer, Inc.*, 4 F.3d 57 (1st Cir. 1993). There, again, the FAA was not involved. Instead, the First Circuit dealt with an issue that was an extension of this Court's decision in *Fabe*. A Puerto Rico insolvency statute provided that if claims were not filed in a timely manner, they received no priority. This provision conflicted with the federal law providing the I.R.S. with first priority in an insolvency case. Using the analysis this Court set forth in *Fabe*, the First Circuit found that the provision was neither directed toward nor necessary for the protection of policyholders.

Here, too, the Fifth Circuit followed the analysis in *Fabe*. Here, however, different state and federal statutes were involved and, therefore, the outcome was different. The fact that the outcomes differ does not create a conflict such as would require this Court to exercise jurisdiction and grant certiorari.

As the foregoing demonstrates, there is no conflict between the Fifth Circuit's decisions and the decisions of any of the other United States courts of appeal. This Court should, therefore, deny the Petition for Writ of Certiorari.

II.

THE FIFTH CIRCUIT FOLLOWED THIS COURT'S PRECEDENTS IN RENDERING ITS DECISION

In *United States Department of Treasury v. Fabe*, 508 U.S. 491 (1993), this Court lent guidance on the question of what constitutes a law enacted "for the purpose of regulating the business of insurance" so as to trigger the reverse preemption granted by Congress in the McCarran-Ferguson Act. The Court considered the priority provisions of Ohio's insolvency laws and whether or not they prevailed over the federal statute giving the United States first priority in an insolvency. The Court held that the statute was enacted "for the purpose of regulating the business of insurance" to the extent it regulated policyholders. As this Court held:

> [t]he Ohio statute is enacted "for the purpose of regulating the business of insurance," to the extent that it serves to ensure that, if possible, policyholders ultimately will receive payment on their claims. That the policyholder has become a creditor and the insurer a debtor is not relevant.

Fabe, 508 U.S. at 506.

The Court ruled that the portion of the statute granting policyholders a higher priority than the I.R.S., was, therefore, enacted for the purpose of regulating the business of insurance.

In addition, this Court found that the priority given to administrative expenses also qualified as a law enacted for the purpose of regulating the business of insurance. The Court held that such a preference was "reasonably necessary to further the goal of protecting policyholders," because without payment of those costs, "liquidation could not even commence." *Fabe*, 508 U.S. at 509.

Following this Court's precedent as set forth in *Fabe*, the Fifth Circuit looked at individual provisions of OUILA.[5] The first provision, found at Okla. Stat. tit. 36, § 1902 (1991), vested exclusive jurisdiction over the insurer's delinquency proceedings in the Oklahoma County District Court. The second, § 1904(B), gives that court the power to enjoin interference with the delinquency proceedings, including the power to prohibit the commencement or prosecution of any actions and the obtaining of preferences and judgments.

These provisions gave the state court the power to decide all issues related to the assets of the insolvent insurance company, the Fifth Circuit noted. The effect of consolidating all proceedings in one court was the creation of a special relationship of cooperation and oversight between the court and the Insurance Commissioner. "This special relationship contributes markedly to the orderly liquidation or rehabilitation of the insurance company and the adjudication of claims against it" and ultimately to the payment of policyholder claims. (Pet. App. 18a.)

The policy of consolidating control in one court had as its end the protection of the relationship between the insurance company and its policyholders. The consolidation eliminated the unnecessary waste of assets that would occur if the receiver were forced to "defend unconnected suits in different forums across the country." It eliminated the risk of conflicting rulings, piecemeal litigation and *unequal treatment of claimants*.

Consolidation in an exclusive forum, the Fifth Circuit held, conserved the assets for ultimate payment to policyholders. (Pet.

5. Although the Fifth Circuit also opined that the whole of OUILA is a law enacted for the purpose of regulating the business of insurance, it did not rely on this analysis to reach its decision, noting that *Fabe* might require the parsing of a state statute to determine the extent to which it might preempt a federal statute under the McCarran-Ferguson Act.

App. 19a.) Although the provision also benefitted creditors of the estate, the Fifth Circuit noted that this did not affect the insurance-related character of the statute in *Fabe*. Statutes aimed at protecting the relationship between an insurer and its insured directly or indirectly were laws regulating the business of insurance. Consequently, the laws were "reasonably necessary to further the goal of protecting policyholders" as prescribed by *Fabe*, and were thus enacted for the purpose of regulating the business of insurance. (Pet. App. 20a.)

Petitioners make the misguided argument that an action in federal court does not fall within the definition of delinquency proceedings under OUILA. However, the jurisdictional provisions found in § 1902 have long been interpreted as meaning that any action against the receiver must be brought in that court. *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699, 706 (10th Cir. 1988); *Professional Construction Consultants, Inc. v. Grimes*, 552 F. Supp. 539 (W.D. Okla. 1982). The disposition of claims against the receiver are, of necessity, part of the delinquency proceedings. *See* Okla. Stat. tit. 36, § 1918 (1991) (providing exclusive procedure for creditors to file claims against the receivership).

Petitioners further argue that the jurisdiction of the Oklahoma County District Court is not exclusive because controverted claims by claimants in reciprocal states may be proved in ancillary proceedings in those states, citing Okla. Stat. tit. 36, § 1916 (1991). That statute actually says that claimants may file such a claim *if* there are ancillary proceedings. However, ancillary proceedings are brought only by the insurance commissioner in a state in which other assets may be found, not by a claimant. *See, e.g.*, Okla. Stat. tit. 36, § 1915(A) (1991).

The Fifth Circuit also followed this Court's decision in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982), when it concluded that the relevant provisions of OUILA regulated the business of insurance. In *Pireno*, the Court formulated a three-

part test. Something constitutes "the business of insurance" if it: (1) transfers and spreads the risk of insurer insolvency; (2) is an integral part of the policy relationship between the insured and the insurer; and (3) is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 129.

As the Fifth Circuit noted,

> it is crucial to the relationship between the insurance company and its policyholders for both parties to know that, in the event of insolvency, the insurance company will be liquidated in an organized fashion.

(Pet. App. 16a.) OUILA's comprehensive regulatory scheme provides this assurance, and is, therefore, an integral part of the policy relationship between the insured and the insurer. Further, contrary to Petitioners' assertions, OUILA applies only to insolvent *insurance* companies, not to insolvent companies generally. Thus, OUILA is limited to entities within the insurance industry.

Although the Fifth Circuit did not examine the third factor, transfer of the policyholder's risk, it did not need to. *Fabe* supplies the needed analysis. There, this Court held that the performance of the terms of the insurance policy satisfies the transfer-of-risk element. *Fabe*, 508 U.S. at 503.

Similarly, in his dissenting opinion in *Pireno*, Justice Rehnquist looked to the legislative history of the McCarran-Ferguson Act and to *Royal Drug* and its predecessors, and noted that the relationship between the insurer and insured was the essence of the definition of "business of insurance" regardless of the inclusion of "risk-spreading" as an indispensable characteristic. In fact, he opined, "[T]he key representation of the insurance company and the principal expectation of the policyholder is that prompt payment will be made when the event insured actually occurs." *Pireno*, 458 U.S. at 136.

Here, OUILA, in liquidating the insolvent insurer, has as its aim the payment of the policyholder under the terms of the insurance contract. *See, e.g.*, Okla. Stat. tit. 36, § 1927.1(B) (1997 Supp.) (providing policyholder claims first priority behind administrative expenses). Performance under the terms of the insurance policy satisfies the other two parts of the *Pireno* test as well: it is central to the relationship between the insurer and the insured, and is confined to entities in the insurance industry. *Fabe*, 508 U.S. at 504. Clearly under both *Fabe* and *Pireno*, OUILA is a state law enacted for the purpose of regulating the business of insurance.

Petitioners next assert the irrelevant argument that

> [m]andating that all actions against an insurance company be brought in state court in the insurance company's domicile also is not an integral part of policy relationship between the insurer and the insured.

(Petition for Writ of Certiorari, pp. 20-21). None of the cases cited involve an insolvent insurance company. Further, two of the cases cited contain no discussion of forum selection, and the third does not support the proposition as applied here. The forum selection clause in a contract with an ongoing, solvent insurance company does nothing to assure the performance of the insurance contract, and may in fact hinder the policyholder who attempts to sue to enforce the contract. On the other hand, as discussed in detail below, the exclusive jurisdiction statute as applied to an insolvent insurance company may make the difference in whether the contract is ever performed as agreed and whether there is any money remaining after liquidation to make payment to the policyholder.

The Fifth Circuit, while it did not cite this Court's decision in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S.

205 (1979) in its opinion, nevertheless followed that precedent as well. In *Royal Drug*, an insurance company contended that its agreement with pharmacies to supply prescriptions at a specified cost was the "business of insurance" and exempt from the application of federal antitrust laws.[6] This Court disagreed. The agreements between the insurer and the pharmacies did not spread the policyholders' risks, but were mere cost-saving measures. While the cost saving might benefit policyholders in the form of lower premiums, the benefit was not the kind of direct benefit necessary to fall under the "business of insurance." The focus of the inquiry in defining the "business of insurance" was the relationship between the insurer and its policyholder, not the relationship between the insurer and medical providers.

Here, the jurisdictional and injunctive provisions are not mere cost-cutting measures. Even if their only purpose were to reduce expenses, the reduction of expenses in liquidating an insolvent insurance company affects the central core of the relationship between the insurance company and its policyholders — the insurance contract. Because the insurance company has a fixed asset base at the time of insolvency, each expense paid by the insolvent company reduces the fund from which policyholders will be paid. Thus, the reduction of administrative expenses in a liquidation may well make the difference between paying the policyholders in accordance with the terms of the contract and not paying them at all.

Further, the OUILA provisions are not just expense cutting measures. As the Fifth Circuit ruled in its opinion, the statutes prevent piecemeal litigation, conflicting rulings and unequal

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6. In *Fabe*, this Court notes that both *Royal Drug* and *Pireno* involve the scope of *antitrust immunity* afforded the business of insurance, a narrowly circumscribed exception to federal preemption of state law. As this Court held, the clause that excepts from preemption *state laws enacted for the purpose of regulating the business of insurance* is not so narrow. *Fabe*, 508 U.S. at 504.

treatment of claimants, all of which may deprive the policyholders of the benefits of their contracts. "Thus, consolidation, enforced through injunctions, conserves the insurance company's assets for ultimate payment to policyholders." (Pet. App. 19a.) It is this conservation of assets for payment to policyholders that makes the OUILA provisions statutes "enacted for the purpose of regulating the business of insurance" as defined by this Court.

Because the Fifth Circuit followed this Court's precedents, the Court should deny the writ of certiorari.

III.

THE FIFTH CIRCUIT DECIDED THIS CASE IN ACCORDANCE WITH FEDERAL POLICIES ARTICULATED IN THE McCARRAN-FERGUSON ACT

Petitioners suggest that the federal policy in favor of arbitration is so strong that this Court should simply ignore the application of the McCarran-Ferguson Act. However, if this Court follows its own directive that "the starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself," the Court should not do as Petitioners request. *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). The McCarran-Ferguson Act provides, at 15 U.S.C. § 1012(b):

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such act specifically relates to the business of insurance.

Of importance here is the inquiry generated by the last sentence: does the federal law at issue, here the FAA, "specifically

relate to the business of insurance?" The FAA does not. This ends the inquiry. No matter how important the policies behind the FAA, if it does not specifically relate to insurance, and the other tests set forth in the McCarran-Ferguson Act are met, the FAA must bow to the state statute.

Here, it is clear that the relevant provisions of OUILA do pass the other tests set forth in the McCarran-Ferguson Act. The FAA invalidates, impairs and supersedes the comprehensive statutory scheme set up by Oklahoma for the liquidation of insolvent insurers.

As discussed *infra*, § 1902 of OUILA gives the Oklahoma County District Court exclusive jurisdiction over any claims of an insolvent insurer involved in delinquency proceedings, and § 1904 allows the court to protect its exclusive jurisdiction by enjoining any other actions against the insurer.

In addition, OUILA § 1918 provides a mandatory method by which the Oklahoma County District Court determines the validity and amount of *all* claims against the insolvent insurer. The FAA, on the other hand, would enforce an arbitration agreement and put the decision concerning the validity and amount of the claim in the hands of arbitrators instead of the Oklahoma court. Thus, here, as in *Fabe*, there is a direct conflict between the Oklahoma statute and the FAA. The FAA, is, accordingly, a law that would "invalidate, impair or supersede" Oklahoma's procedure for determination of claims by the receivership court.

The FAA would also invalidate the priority scheme carefully articulated by the Oklahoma legislature in § 1927.1. That statute places the policyholders first after administrative expenses for payment from the assets of the estate. Reinsurers such as Petitioners are placed in the general creditor class, below the priority of policyholders and the federal government. Further, the statute prescribes that "[n]o claim . . . shall be permitted to circumvent

the priority classes through the use of equitable remedies," thus rejecting any "salvage" claim. Okla. Stat. tit. 36, § 1927.1(A)(1997 Supp.) If Petitioners are allowed to arbitrate pursuant to the FAA, the arbitrators may declare the settlement fund to be salvage and award Petitioners title to the fund, effectively moving Petitioners to the front of the priority line — before policyholders — in violation of the legislative liquidation scheme.

OUILA is also a state law enacted "for the purpose of regulating the business of insurance," because it furthers the interests of policyholders. Under insurer liquidation statutes, it is the Receiver's specific duty to gather the assets, determine the claims against the company and administer the affairs of the insurer *for the benefit of the policyholders*. *Garris v. Carpenter*, 92 P.2d 688, 33 Cal. App. 2d 649 (1939); *Pensinger v. Pacific States Life Ins. Co.*, 25 F. Supp. 295 (D. Mo. 1938). It is in this manner that the Oklahoma statute protects policyholders and assures they will receive payment. Thus, the provisions of OUILA, the exclusive jurisdiction of § 1902, the injunction to prevent interference with the state court contained in § 1904, and the claims procedure found in § 1918, all prevail over the FAA.

Petitioners cite many cases that undeniably state that the federal interest in enforcing arbitration agreements is very strong.[7] However, regardless of how important Congress thought it was to enforce arbitration, it did not deem it important enough to make the FAA specifically relate to the business of insurance, so as to

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7. Among the cases cited by Petitioners is this Court's decision in *Quackenbush v. Allstate Insurance Co.*, 517 U.S. 706 (1996) (*Quackenbush I*). As noted in the discussion regarding *Quackenbush II*, however, the posture of that case differs from the instant case, in that the receiver was the plaintiff there, where he is the defendant here. Further, as noted by Petitioners, this Court did not address the impact of the McCarran-Ferguson Act on the FAA in *Quackenbush I*. This fact also makes *Quackenbush I* a much different case than the one before this Court today.

avoid the reverse preemption of the McCarran-Ferguson Act. It would have been a simple matter to do so. Congress did not. This Court should not now write into the FAA a provision that Congress chose not to include.

IV.

THE FIFTH CIRCUIT'S DECISION REGARDING THE STATE COURT'S POWER TO ISSUE ITS INJUNCTION IS IN ACCORD WITH THE DECISIONS OF OTHER CIRCUITS AND OF THIS COURT

The Fifth Circuit's pronouncement regarding a state court's power to enjoin an *in personam* action are in perfect accord with other circuit's decisions. This is what, precisely, the Fifth Circuit said:

> We surely are not saying that a State has the power to enjoin a party generally from pursuing federal remedies in federal court. Nor are we saying that Oklahoma law divested the district court of its diversity jurisdiction. *See Martin*, 910 F.2d at 254 (rejecting the argument that McCarran-Ferguson Act removes diversity jurisdiction from federal courts in insurance matters). What we are saying is that, by operation of the McCarran-Ferguson Act, a federal act that permits states to exert broad power over the insurance industry, state laws regulating the business of insurance may suspend federal remedies based on conflicting federal statutes – here, the FAA.

(Pet. App. 25a-26a.)

The Fifth Circuit's statement in no way conflicts with *Murff's* holding that a "state court cannot . . . enjoin federal court actions."

Further, when the Eighth Circuit held that the ADEA did not impair the Missouri insolvency statutes in *Murff*, it found that the McCarran-Ferguson Act did not even apply. Thus, the Eighth Circuit has not addressed whether the McCarran-Ferguson Act may properly suspend federal remedies when they conflict with state laws enacted for the purpose of regulating the business of insurance.

The same is true with the First Circuit decision in *Fragoso*, which ruled that "a state court cannot enjoin federal proceedings." There, the court never considered the McCarran-Ferguson Act. Because it did not, its decision does not pose a conflict with the Fifth Circuit's decision below.

The Fifth Circuit's holding is in accord with this Court's decisions as well. In fact, the very cases Petitioners hold up as contradicting the Fifth Circuit's decision were cited by the Fifth Circuit and reconciled with its holding: *Donovan v. Dallas*, 377 U.S. 408 (1964), *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), and *General Atomic Co. v. Felter*, 434 U.S. 12 (1977).

As the Fifth Circuit noted, none of these cases addressed the question of what affect the application of the McCarran-Ferguson Act has on the state court's power to enjoin the pursuit of federal remedies in an *in rem* or *quasi in rem* action. Both *Moses H. Cone* and *General Atomic* were *in personam* actions. The McCarran-Ferguson Act was not at issue in either case.

Donovan was also an *in personam* action which did not involve the McCarran-Ferguson Act. Nevertheless, the language of *Donovan* supports the Fifth Circuit's decision. As this Court noted in *Donovan*, state and federal courts may not interfere with or try to restrain each other's *in personam* proceedings. However, when the action is *in rem*, the rules change. When the action is *in rem*, the court first taking jurisdiction over the *res* exercises exclusive jurisdiction.

This Court discussed the difference between the treatment of *in personam* and *in rem* or *quasi in rem* cases in *United States v. Bank of New York & Trust Co.*, 296 U.S. 463, 477-79 (1936), a case cited by the Fifth Circuit. (Pet. App. 23a, n. 6.)

In *Bank of New York*, the United States filed suit against a liquidator, claiming by assignment all assets of the insolvent insurer. The suit was dismissed. On appeal, this Court reiterated the rule that the first court assuming jurisdiction over a *res* shall maintain jurisdiction to the exclusion of all other courts. The Court held that this rule is not limited to cases where the property is actually seized, but applies also to cases such as a delinquency proceeding, where the suit is one to marshall assets and administer an estate. The Court also noted that the suit by the United States was not an *in personam* suit as the United States argued, but one to obtain possession of a particular fund. As the Court noted, the United States demanded that the holder of the funds account for and pay to the U.S. the entire fund in its hands.

> Thus the object of the suits is to take the property from the depositories and from the control of the state court, and to vest the property in the United States to the exclusion of all those whose claims are being adjudicated in the state proceedings.

Bank of New York, 296 U.S. at 478.

Here, ENIC was declared insolvent and Respondent was appointed its receiver. Respondent was called to marshall the assets of the insolvent insurer and to administer the estate. The settlement funds in question are under the control of the state court. As a result, the state proceeding is *quasi in rem*. Further, although Petitioners characterize their Petition to Compel Arbitration as an *in personam* action only, their pleading urges the funds "as a matter of law are deemed to be held in trust" by Respondent for the Petitioners. (Resp. App. 14a.) Petitioners clearly sought to take

the fund in question from the Respondent and from the control of the state court and vest it in Petitioners to the exclusion of the claimants, including the policyholders, of the Respondent. Under this Court's decisions in *Donovan* and *Bank of New York*, Petitioners may not do so.

V.

THE FIFTH CIRCUIT COULD ALSO HAVE UPHELD THE DISTRICT COURT'S DECISION UNDER THIS COURT'S DECISION IN *BURFORD*

Although a federal court has a duty to exercise the jurisdiction conferred upon it by Congress, that duty is not absolute. A court may decline to exercise its jurisdiction in cases where denying a federal forum will serve an important countervailing interest. *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 716 (1996).

Burford and its progeny instruct that one such countervailing interest arises when the exercise of federal jurisdiction "would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Quackenbush I*, 517 U.S. at 726-27. *Burford* requires abstention where the exercise of federal court jurisdiction would interfere with a specialized, unified state court system of adjudication designed to avoid inconsistent adjudication of claims arising from a comprehensive, detailed, and complex regulatory scheme in a subject area involving state law. *Quackenbush I*, 517 U.S. at 716.

Here, pursuant to OUILA, the Oklahoma state court enjoined any action against the Respondent. As discussed above, OUILA provides a comprehensive and specific procedure requiring that all claims against the insolvent insurer be prosecuted in the receivership court. The procedure serves public policy by assuring the orderly liquidation of the insolvent insurer, and aids in the protection of policyholders by achieving the maximum payment

on their claims. *Burford* abstention is proper here to prevent the circumvention of the claims procedure and exclusive jurisdiction that would arise if a federal court exercises jurisdiction over claims against an insolvent insurer. Abstention prevents interference with the *in rem* jurisdiction of the receivership court and with the specialized and unified regulatory system set up by the Oklahoma Legislature to liquidate insolvent insurers.

The Fifth Circuit ruled that *Burford* abstention would not be proper under this Court's decision in *Quackenbush I*. The court held that, because the relief sought by Petitioners was neither equitable nor committed to the discretion of the district court, it simply could not abstain in this case.

The court of appeals failed to recognize that the nature of Petitioners' claim is purely equitable. As this Court did in *Quackenbush I*, the Fifth Circuit should have looked at the nature of the underlying claim to determine whether it was equitable or legal. Although Petitioners urge that they only claim damages, their Petition to Compel Arbitration clearly shows otherwise. Petitioners state that the settlement funds constitute "salvage" and urge that the law deems the funds to be held in trust by Respondent for the benefit of Petitioners. (Resp. App. 13a. and 14a.) Their claim for salvage is an equitable claim. Thus, the district court's dismissal under *Burford* was appropriate.

The Fifth Circuit also misreads this Court's decision in *Quackenbush I*. Justice O'Connor, writing for the Court, stated that the Supreme Court has "permitted federal courts applying abstention principles in damages actions to enter a stay," where an outright dismissal would be impermissible, and noted that a stay in the district court might have been in order. *Quackenbush I*, 517 U.S. at 730-31. Because it only reviewed the remand order entered by the Ninth Circuit, however, the Court found it "unnecessary to determine whether a more limited abstention-based stay" was appropriate. *Quackenbush* I, 517 U.S. at 731. Here, a stay would have been proper.

Burford abstention is further justified because application of the priority scheme in § 1927.1 of OUILA to equitable reinsurance claims, such as salvage, is a matter of substantial state concern. That statute, put in place in part as a response to this Court's decision in *Fabe*, is completely untested. For these reasons, the district court in this action could have entered a stay of proceedings in accordance with this Court's rulings in *Burford* and *Quackenbush I*.

CONCLUSION

The Fifth Circuit's decision is in accord with this Court's precedents and does not conflict with decisions of other United States courts of appeal. The Court should, therefore, deny the Petition for Writ of Certiorari.

Respectfully submitted,

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APPENDIX

APPENDIX A — FEDERAL ARBITRATION ACT, 9 U.S.C. SECTIONS 1-16

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the

manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

APPENDIX B — OKLAHOMA UNIFORM INSURERS LIQUIDATION ACT ("OUILA"), OKLA. STAT. TIT. 36, §§ 1901-1938

§ 1918. Proof of claims; notice; hearing

A. All claims against an insurer against which delinquency proceedings have been begun shall set forth in reasonable detail the amount of the claim, or the basis upon which such amount can be ascertained, the facts upon which the claim is based, and the priorities asserted, if any. All such claims shall be verified by the affidavit of the claimant, or someone authorized to act on his behalf and having knowledge of the facts, and shall be supported by such documents as may be material thereto.

B. All claims filed in this state shall be filed with the receiver, whether domiciliary or ancillary, in this state, on or before the last date for filing as specified in this article.

C. Within ten (10) days of the receipt of any claim, or within such further period as the court may, for good cause shown, fix, the receiver shall report the claim to the court, specifying in such report his recommendation with respect to the action to be taken thereon. Upon receipt of such report, the court shall fix a time for hearing the claim and shall direct that the claimant or the receiver, as the court shall specify, shall give such notice as the court shall determine to such persons as shall appear to the court to be interested therein. All such notices shall specify the time and place of the hearing and shall concisely state the amount and nature of the claim, the priorities asserted, if any, and the recommendation of the receiver with reference thereto.

D. At the hearing, all persons interested shall be entitled to appear and the court shall enter an order allowing, allowing in part, or disallowing the claim. Any such order shall be deemed to be an appealable order.

Appendix B

§ 1927.1 Priority of distribution of claims from insurer's estate

A. The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Before the members of the next class receive any payment, every claim in each class shall be:

1. Paid in full; or

2. Protected by adequate funds retained for such payment.

Once such funds are approved by the court and paid or retained by the liquidator, the insurer's estate shall have no further liability to members of that class except to the extent of the retained funds and any other undistributed funds. Payment of retained funds pursuant to court order under this section extinguishes the potential liability of the receiver to the United States or any other governmental entity. No subclasses shall be established within any class except as otherwise provided by law. No claim by a shareholder, policyholder or other creditor shall be permitted to circumvent the priority classes through the use of equitable remedies. The order of distribution of claims shall be as provided in subsection B of this section.

B. 1. Class 1. The reasonable costs and expenses of administration expressly approved by the receiver, including but not limited to the following:

a. the actual and necessary costs of preserving or recovering the assets of the insurer,

b. compensation for all authorized services rendered in the conservation, rehabilitation or liquidation,

c. any necessary filing or recordation fees,

d. the fees and mileage payable to witnesses, including experts, and other litigation costs and expenses,

e. authorized reasonable attorney's fees and other professional services rendered in the conservation, rehabilitation or liquidation, and

f. any reasonable expenses that were incurred in furtherance of activities that provided a material economic benefit to the estate.

2. Class 2. The administrative expenses of guaranty associations. For purposes of this section these expenses shall be the reasonable expenses incurred by guaranty associations where the expenses are not payments or expenses which are required to be incurred as direct policy benefits in fulfillment of the terms of the insurance contract or policy, and that are of the type and nature that, but for the activities of the guaranty association otherwise would have been incurred by the receiver, including but not limited to evaluations of policy coverage, activities involved in the adjustment and settlement of claims under policies, including those of in-house or outside adjusters, and the reasonable expenses incurred in connection with the arrangements for ongoing coverage through transfer to other insurers, policy exchanges or maintaining policies in force. The receiver may in his or her sole discretion approve as an administrative expense under this section any other reasonable expenses of the guaranty association if the receiver finds:

a. the expenses are not expenses required to be paid or incurred as direct policy benefits by the terms of the policy, and

b. the expenses were incurred in furtherance of activities that provided a material economic benefit to the estate as a whole, irrespective of whether the activities resulted in additional benefits to covered claimants.

The court shall approve such expenses unless it finds the receiver abused his or her discretion in approving the expenses. If the receiver determines that any administrative expenses of a guaranty association were not reasonable expenses, but were nevertheless paid out of a statutory deposit or the proceeds of any bond or other asset located in another state or foreign country, then the court shall adjudge the Class 3 claims of that association to have been paid to the extent of the amount of unreasonable expenses thus paid from those assets.

If the receiver determines that the assets of the estate will be sufficient to pay all Class 1 claims in full, Class 2 claims shall be paid, provided that the liquidator shall secure from each of the associations receiving disbursements pursuant to this section an agreement to return to the liquidator such disbursements, together with investment income actually earned on such disbursements, as may be required to pay Class 1 claims. No bond shall be required of any such association.

3. Class 3. All claims under policies including claims of the federal or any state or local government for losses incurred ("loss claims") including third party claims, claims for unearned premiums, all claims of a guaranty association for payment of

covered claims or covered obligations of the insurer and all claims of a guaranty association for reasonable expenses other than those included in Class 2. All claims under life and health insurance and annuity policies, whether for death proceeds, health benefits, annuity proceeds, or investment values shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligation of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to his employee shall be treated as a gratuity.

Notwithstanding the foregoing, the following claims shall be excluded from Class 3 priority:

a. obligations of the insolvent insurer arising out of reinsurance contracts,

b. obligations incurred after the expiration date of the insurance policy or after the policy has been replaced by the insured or canceled at the insured's request or after the policy has been canceled as provided in this act. Notwithstanding the provisions of this paragraph, earned premium claims on policies, other than reinsurance agreements, shall not be excluded,

c. obligations to insurers, insurance pools or underwriting associations and their claims for contribution, indemnity or subrogation, equitable or otherwise,

d. any claim which is in excess of any applicable limits provided in the insurance policy issued by the insolvent insurer,

e. any amount accrued as punitive or exemplary damages unless expressly covered under the terms of the policy, and

f. tort claims of any kind against the insurer, and claims against the insurer for bad faith or wrongful settlement practices.

4. Class 4. Claims of the federal government other than those claims included in Class 3.

5. Class 5. Debts due employees for services, benefits, contractual or otherwise due arising out of such reasonable compensation to employees for services performed to the extent that they do not exceed two (2) months of monetary compensation and represent payment for services performed within six (6) months before the filing of the petition for liquidation or, if rehabilitation preceded liquidation, within one (1) year before the filing of the petition for rehabilitation. Principal officers and directors shall not be entitled to the benefit of this priority except as otherwise approved by the liquidator and the court. This priority shall be in lieu of any other similar priority which may be authorized by law as to wages or compensation of employees.

6. Class 6. Claims of any person, including claims of state or local governments, except those specifically classified elsewhere in this section.

Appendix B

7. Class 7. Claims for commissions and service fees, and claims of attorneys for fees and expenses owed them by a person for services rendered in opposing a formal delinquency proceeding. In order to prove the claim, the claimant must show that the insurer which is the subject of the delinquency proceeding incurred such fees and expenses based on its best knowledge, information and belief, formed after reasonable inquiry indicating opposition was in the best interests of the person, was well grounded in fact and was warranted by existing law or a good faith argument for the extension, modification or reversal of existing law, and that opposition was not pursued for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of the litigation.

8. Class 8. Claims of any state or local government for a penalty or forfeiture, but only to the extent of the pecuniary loss sustained from the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under paragraph 9 of this section.

9. Class 9. Surplus or contribution notes or similar obligations, premium refunds on assessable policies, interest on claims of Classes 1 through 8 and any other claims specifically subordinated to this class.

10. Class 10. Claims of shareholders or other owners arising out of their capacity as shareholders or other owners, or arising in any other capacity or facts except as they may be qualified in Class 3 or 4 above.

APPENDIX C — PETITION TO COMPEL ARBITRATION UNDER THE FEDERAL ARBITRATION ACT AND APPLICATION FOR TEMPORARY RESTRAINING ORDER AND FOR PRELIMINARY INJUNCTION PENDING ARBITRATION, FILED JULY 18, 1996

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

No. 3:96-CV-2024-T

IN THE MATTER OF THE
ARBITRATION BETWEEN

MUNICH AMERICAN REINSURANCE COMPANY, AND NAC REINSURANCE CORPORATION,

Petitioners,

v.

JOHN R. CRAWFORD, INSURANCE COMMISSIONER OF THE STATE OF OKLAHOMA, AS RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION,

Respondent.

PETITION TO COMPEL ARBITRATION UNDER THE FEDERAL ARBITRATION ACT AND APPLICATION FOR TEMPORARY RESTRAINING ORDER AND FOR PRELIMINARY INJUNCTION PENDING ARBITRATION

COMES NOW, MUNICH AMERICAN REINSURANCE COMPANY ("Munich American") and NAC REINSURANCE

Appendix C

CORPORATION ("NAC Re"), formerly known as North American Company for Property and Casualty Insurance, Petitioners in the above-styled and numbered cause, seeking (1) an Order under section four of the Federal Arbitration Act, 9 U.S.C. § 4, compelling arbitration of their disputes with the Respondent, JOHN R. CRAWFORD, INSURANCE COMMISSIONER OF OKLAHOMA, AS THE RECEIVER OF EMPLOYERS NATIONAL INSURANCE CORPORATION and (2) a temporary restraining order and preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure to maintain the status quo pending arbitration and award:

* * *

6. Pursuant to Umbrella Liability Reinsurance Agreement CAF 4139 ("MARC Agreement") between Munich American and Employers Casualty Company (including subsidiaries) (collectively the "Company"), effective January 1, 1986, Munich American agreed to pay to the Company a certain percentage share of the amount of net loss allocable under each Umbrella policy covered by the MARC Agreement. (A copy of the MARC Agreement is annexed as Exhibit A).

7. Pursuant to an Umbrella Liability Reinsurance Agreement ("NAC Re Agreement") between North American Company for Property and Casualty Insurance, now NAC Re, and Employers Casualty Company (including subsidiaries) (collectively the "Company"), effective January 1, 1986, NAC Re agreed to pay to the Company a certain percentage share of the amount of net loss allocable under each Umbrella policy covered by the NAC Re Agreement. (A copy of the NAC Re Agreement is annexed as Exhibit B).

Appendix C

8. Under the MARC Agreement and the NAC Re Agreement (collectively, the "reinsurance agreements") "net loss" means, "all payments by the Company in settlement of claims or losses . . . after deduction of salvage . . . ." (*See* Exs. A and B at Article IV(A)). "Salvage" is defined in the respective reinsurance agreements as follows:

> *Salvage* - This term shall mean any recovery made by the Company in connection with a claim or loss, less all expenses paid by the Company, other than payments to any salaried employee of the Company making such recovery.

(Exs. A and B at Article IV(C)). The agreements also provide for subsequent adjustments in net loss and payment of any amounts due either party:

> Upon receipt of a definite statement of net loss from the Company, the Reinsurer shall promptly pay to the Company the Reinsurer's portion of net loss and the Reinsurer's portion of adjustment expense, if any. Any subsequent changes in the amount of net loss shall be reported by the Company to the Reinsurer and the amount due either party shall be remitted promptly.

(Exs. A and B at Article XII(A)).

* * *

10. In 1991, Jobs Building Services, Inc. ("JOBS") settled a wrongful death claim requiring ENIC to pay $2,065,000 under an umbrella policy. Pursuant to their respective reinsurance

agreements, Munich American paid $829,250, plus expenses, and NAC Re paid $829,250, plus expenses, as their respective shares of ENIC's net loss.

* * *

12. In June 1995, the net settlement funds, in the amount of $1,500,000, were tendered to and accepted by the Receiver on behalf of ENIC. (A copy of an October 4, 1995 letter to NAC Re acknowledging receipt by ENIC in Receivership is annexed as Exhibit C).

13. Munich American and NAC Re claim subrogation rights to these settlement funds because they constitute "salvage" recovered in connection with the JOBS claim for which Munich American and NAC Re have paid their respective shares under the reinsurance agreements.

14. Disputes have arisen between the Receiver and Munich American and NAC Re concerning Munich American's and NAC Re's claims to their shares of these settlement funds.

15. The Receiver refuses to tender to Munich American and NAC Re their respective shares of these settlement funds.

16. Each of the reinsurance agreements contains an agreement to arbitrate disputes. Article XV, entitled "Arbitration," which is identical in both reinsurance agreements, provides in part:

> As a condition precedent (sic) to any right of action hereunder, any dispute arising out of this Agreement, as well as any differences concerning

> the validity of this Agreement, shall be submitted to the decision of a board of arbitration composed of two arbitrators and an umpire meeting in Dallas, unless otherwise agreed. The laws of the State of Texas shall govern the interpretation of this Agreement.

(*See* Exs. A and B at Article XV(A)).

* * *

21. Upon information and belief, the Receiver has retained the settlement funds and has not as yet used or disposed of them in any manner. Munich and NAC Re have advised the Receiver that these settlement funds are not part of the ENIC insolvency estate, but as a matter of law are deemed to be held in trust by the Receiver for Munich and NAC Re as subrogees. However, the Receiver refuses to relinquish control of the settlement funds to Munich American and NAC Re.

* * *

WHEREFORE, PREMISES CONSIDERED, Petitioners Munich American Reinsurance Company and NAC Reinsurance Corporation respectfully pray that the Court issue an Order compelling the Receiver to proceed with arbitration and a preliminarily (sic) injunction to preserve the status quo pending arbitration prohibiting the Receiver from using, encumbering, or otherwise disposing of the settlement funds of $1,500,000, and the interest earned thereon, pending the arbitration and award, and such other relief as the Court deems appropriate.